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Supreme Court of the United States

OCTOBER TERM, 1927.

No. [redacted] 31

BOTANY WORSTED MILLS,
Petitioner,

vs.

THE UNITED STATES.

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR PETITIONER.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1927.

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BOTANY WORSTED MILLS, *Petitioner,* *vs.* THE UNITED STATES.	ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR PETITIONER.

A. IN RESPONSE TO THE BRIEF SUBMITTED *Amicus Curiae.*

The argument contained in the brief *amicus curiae*, filed herein, is predicated on an assumption of fact which has no support in the findings of the Court of Claims.

Such assumption is that in the informal settlement the petitioner gained, and seeks to retain, certain advantages conceded to it in the adjustment of the two questions involved other than that of directors' compensation. Proceeding upon this assumption the brief argues that, inasmuch as the petitioner cannot now be divested of such advantages because of the running against the Government of the Statute of Limitations, it should not be permitted to recover.

The authors of the brief frankly state that they have relied for their facts on the briefs submitted in behalf of the defendant in the Court of Claims. Such view of the facts is not supported by the findings. The Solicitor

General concedes that the findings do not disclose a ground for estoppel. (Government's brief, p. 12.)

What the findings do disclose is that three questions were in issue (Finding XIX, R. 18), that a compromise was agreed to as to all of the differences, and that the allowance for directors' compensation was adjusted on the basis of the amount paid in 1918 (R. 19). There is no finding, direct or implied, that petitioner received any concession as to the other two questions. On the contrary it appears that, as a result of the negotiations, an additional assessment was made for the year 1917 of $703,578.37 of which only $450,994.06 was attributable to the disallowance on account of directors' compensation (Finding IV, R. 11).

Thus, it appears that both the brief *amicus curiae* and that of the Solicitor General (p. 12) are in error in assuming that the representatives of the Bureau of Internal Revenue acquiesced in the petitioner's claims as to the other two questions involved. That such cannot be the case is clear from the fact that additional assessments of $252,584.31 were imposed upon the petitioner with respect to the other items in dispute.

The contention in the brief *amicus curiae* that the defendant was precluded by the Statute of Limitations from claiming any offsets against the petitioner, is not made by the Solicitor General who asserts correctly (see brief for U. S., pp. 12-13) that if the adjustment was not conclusive, the Government, on a judicial inquiry as to the correctness of the 1917 tax, is in as good a position as it ever was to question all deductions. The Court of Claims, in the exercise of its equitable jurisdiction, (See *U. S.* v. *Milliken Imprinting Co.*, 202 U. S. 168) is not precluded by the running of any Statute of Limitations from directing, as a condition of recovery, allowance of any claims which should properly be offset against it. (See *Talbot* v. *Hill*, 261 Fed. 244, 245-6; *People* v. *Freeman*, 110 App. Div. (N. Y.) 605, 608; *De Walsh* v. *Bra-*

man, 160 Ill. 415.) Furthermore, it appears from the findings that petitioner made its claim for a refund of the tax in question on February 1, 1922 (R. 12) while the statutory time within which additional assessments might be made did not expire until March 15, 1923. The Commissioner, therefore, had more than a year, after being put on notice that petitioner was resorting to its statutory remedies for a review of the 1917 tax, within which to make additional assessments if he believed any to be justified. His inaction during that year should not work to estop the petitioner. The authors of the brief *amicus curiae* are apparently unaware that a formal waiver of the Statute of Limitations was filed by petitioner in the Court of Claims.

The brief *amicus curiae* contributes nothing new to the law of this case. In the cases of *The Lone Star Brewing Association* v. *U. S.*, 61 Ct. Cls. 118, *Walker* v. *Alamo Foods Co.*, 16 Fed. (2d) 694, and *Rau* v. *U. S.*, 260 Fed. 131, cited at pages 18-21 of the brief, there had been a written agreement made pursuant to the provisions of Sec. 3229 R. S. This is conceded at page 22 of the brief.

To support the contention that the right and power exist to compromise such matters without reference to the statutory authority conferred under Sec. 3229, are cited, at pages 23 and 24 of the brief *amicus curiae*, the cases of *Mason* v. *U. S.*, 17 Wall. 67, *Sweeney* v. *U. S.*, 17 Wall. 75 and *Savage, Exec.* v. *U. S.*, 92 U. S. 382.

In the *Savage* case the opinion states that

> "Parties having claims against the United States which are disputed *by the officers authorized to adjust them* may compromise the claims," etc. (p. 388. Italics ours.)

This qualification that the compromise must be by officers authorized to adjust the claims is expressly recognized in each of the other two cases.

The decisions of this court, cited at page 18 of the brief, to wit: *McLean* v. *Clapp,* 141 U. S. 429, and *Grymes* v. *Sanders,* 93 U. S. 55, deal with the principles governing actions for rescission of contracts for fraud or mistake. They have no bearing on the issues here in controversy.

The contentions of the brief that the acts of the Commissioner, "within the scope of his authority, must be considered the official acts of the Secretary of the Treasury" (p. 48) and that having general authority he "is not required to find express statutory authority for all his acts in order to establish their validity or binding force" (p. 50) have no cogency in the face of the provisions of Sec. 3229 R. S. giving the Commissioner express authority to make compromises "with the advice and consent of the Secretary of the Treasury".

The argument set forth at pages 51-57 of the brief *amicus curiae* entirely overlooks the well established principle that the Government cannot be estopped by the unauthorized actions of its agents. (See p. 14 of Petitioner's main brief.) Whether or not an estoppel arises depends in the main upon the facts of the particular case. Without detailed reference to the many decisions cited in the pages of the brief above referred to, it seems to us obvious that they furnish no parallel with the facts in this case as found by the Court of Claims, upon which no estoppel can be predicated.

B. Concerning the Sufficiency of the Findings to Warrant a Final Determination by this Court.

In contending that the findings of the Court of Claims are not sufficient to sustain a decision that the amounts paid to the directors for 1917 were "ordinary and necessary expenses" and therefore deductible by the petitioner under the 1916 Act (quoted at p. 18 of our main brief), the Solicitor General entirely overlooks the fact

that such compensation was paid pursuant to a contract enforceable against the corporation and was, consequently, a necessary expenditure.

That it was also an ordinary expense is shown by two facts set forth in the findings. The first is that this method of compensation had been in existence in the corporation since the year 1890 (R. 12-14). It was ordinary to the corporation. Second, the method of compensating directors and executives on a basis of a percentage of profits had for many years been the practice of many corporations in the woolen manufacturing business (R. 20). Thus, it was, also, ordinary in the business as a whole.

While the total amount of the compensation paid to the ten directors in the year 1917 of $1,565,739.39 was extraordinarily large, it appears from Finding XIV (R. 17) that the average amount paid to the directors for the eight years 1910-1917 was approximately $459,000, which is some $134,000 less than the Commissioner considered reasonable for the year 1918 for an almost entirely new board (Findings XV, R. 17, XX, R. 20, and XI, R. 15). Directors and executives who serve for compensation contingent on success have to take the lean years with the fat. Their compensation, as thus averaged, was not extraordinary in a business enterprise of the magnitude of the Botany Worsted Mills. While we do not conceive that the question of whether the stockholders acted wisely or not, in providing for such method of remunerating those whom they put in charge of their business, is at issue, the finding which shows the increases in the net income of the business (R. 17) sufficiently demonstrates the practical wisdom and reasonableness of their policy.

The reasoning of the Circuit Court of Appeals for the Third Circuit in the opinion in *U. S.* v. *Philadelphia Knitting Mills Co.*, 273 Fed. 657, seems to us so conclusive that we can add nothing to it. The case was cited

as authoritative by the Circuit Court of Appeals for the Second Circuit in *Becker Bros.* v. *United States*, 7 Fed. (2d) 3, 6, 7. Under the facts as stated in the opinion in the *Knitting Mills* case certain salaries had been paid as determined by the board of directors and not pursuant to any contract providing for compensation. It was, therefore, in that case, an open question whether the amounts paid really represented salaries or a distribution of profits under the guise of compensation. The court held that to overcome the "presumption arising from the action of the board of directors that it was all salary" the burden was on the Government to produce evidence, not necessarily conclusive, but sufficient to raise a valid inference that some definite part of the compensation was not salary but was profits". In our case the findings show that the partial disallowance of the deduction was "on the ground that the amounts paid *as compensation* were" unreasonable. (Finding IV, R. 11.) The opinion states that "the Government has not claimed that any part of the payments to the directors was not compensation". (R. 24.) The defendant has not even attempted to meet the burden of proof. On the other hand, the findings show that the payments to the directors were made under and pursuant to a by-law directing such payment as "a compensation" (Finding XI, R. 14). The fact that this phrase originated as far back as the by-law adopted in 1905 (Finding IX, R. 13), precludes the possibility that it was devised as a method of disguising, for income tax purposes, a distribution of profits.

It is respectfully submitted that none of the suggested additional findings as to the extent and value of the services rendered by the directors, the basis of the distribution among them of the total compensation, or as to their other relations to the corporation or the amount of stock held by each could in any way affect the conclu-

sions which follow as a matter of law from the findings that have already been made by the Court of Claims.

The 1916 Act permitted the petitioner to deduct all the necessary and ordinary expenses paid by it in the maintenance and operation of its business. No special mention was made of salaries or compensation of officers and directors and there is, therefore, no statutory authority for differentiating such expenditures from any other. The court below has found facts which show that there was an implied contract with each of the directors to pay him for his services in accordance with the by-laws and customary practices of the company (Finding XIV, R. 16), and that the compensation was paid in accordance with the by-laws (Finding III, R. 11). They show also that the distribution among the directors was made in accordance with the ordinary practices of the company (Finding XIII, R. 16) and also, as we have pointed out above, that the method of compensation was an expense ordinary both to the conduct of petitioner's business and in the woolen industry as a whole. In accordance with such findings the petitioner was entitled, under the statute, to deduct such expenditure in arriving at the amount of its net income.

Respectfully submitted,

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